O-3073

OFFICE OF THE ATTORNEY GENERAL OF TEXAS

AUSTIN

GERALD C. MANN
ATTORNEY GENERAL

Honorable George H. Sheppard
Comptroller of Public Accounts
Austin, Texas

Dear Sir:

Opinion No. O-3073
Re: (a) Proper elements to be considered by State Tax Board in determining income or earnings to be capitalized, in assessing three described "pipe line companies" for ad valorem taxes on intangibles under Article 7105, Revised Civil Statutes. (b) Yardstick to be used in measuring or classifying a pipe line operated in connection with the refining or production of crude oil. (c) Whether intangible value attaches or adheres to physical or tangible properties, or to the business of transporting oil by pipe line.

In your capacity as Ex-Officio Tax Commissioner, you submitted for the opinion of this Department, the following question, which we quote from your letter of January 20, 1941:

"A recent decision in the case of Col-Tex Refining Co. v. Bruce Hart et al, 144 S. W. 2nd 909, relative to intangible values, necessitates my requesting an opinion on the points set forth below:

"Company C operates a private pipe line in connection with its oil producing business. In addition it gathers for other producers in the same field, on which a gathering charge is made, against the other producers of five cents per barrel, or they are allowed to make a five cent

profit when the oil is delivered to a common carrier pipe line. Without the gathering system the common carrier pipe line would have charged five cents per barrel for this service.

"Company D operates a gathering system, in connection with its refinery, but it sells part of the oil to a common carrier pipe line. This service would have cost five cents per barrel, should the common carrier gathered the oil, as in the case of Company C.

"Company E operates a pipe line under lease agreement. The properties are owned by a refinery, but the operating company is incorporated as an oil pipe line company. Or they may buy oil in the field and sell it to the refinery and/or other refineries and common carriers, with no contract to sell, but the sales are made without any pre-determined profit. The pipe line and/or marketing company may make more or less than the gathering charge. The lease agreement may stipulate, (a) that all ad valorem taxes are to be paid by the owner (refinery) or (b) that all ad valorem taxes are to be borne by the lessee company. Also it may stipulate, (c) that the rental be paid on a flat rate per month or annum, or (d) that the rental be based on a per barrel rate, for example the rate would be three cents per barrel on all oil gathered.

"The main questions involved may be summarized as follows:

"1. What is gross income, as applied to a pipe line with no published tariffs? Is oil trading profits an income in the case of Companies C and D? Are savings on their own oil to be considered in arriving at their total gross income?

"2. Is there any yard-stick to be used in measuring or classifying a pipe line operated in connection with the refining or pro-

duction of crude oil?

"3. Does an intangible value, as found, attach itself to the physical properties, or to the business of transporting oil by pipe line? It may be presumed that Company E will have office furniture and other property that will be used in their marketing and pipe line business, however the intangible value would ordinarily be apportioned to the counties through which the pipe lines are situated.

"Article 6019 reads, in part as follows:

"'It is declared that the operation of common carrier pipe lines is a business in which the public is interested, and is subject to regulation by law. The business of purchasing, or of purchasing and selling crude petroleum, using in connection with such business a pipe line of the class subject to this law to transport the crude petroleum so bought or sold, shall not be conducted, unless such pipe line so used is a common carrier within the purview of this law. . . .' (Underscoring ours)

"On the presumption that Companies D and E are 'Owning, operating or managing' a pipe line that comes within the above statute, or that they are 'Doing business of the same character in this State'; is their revenue to be predicated on a tariff, where one is established and published by a common carrier pipe line? Or is their income to be considered the same as that oil trading profit from buying, transporting and selling oil? From a practical standpoint, if we are confined to oil trading profits there will be no intangible value. On the other hand, if tariffs are set up on all oil transported, a hypothetical, or earning capacity of the property as distinguished from the actual earnings, is the basis of an intangible value.

"Until the Col-Tex case was decided the pipe line industry had taken the practical construction

of that part of Article 6018 reading as follows: 'The provisions of this law shall not apply to those pipe lines which are limited in their use to the wells, stations, plants and refineries of the owner. . . .' to mean the pipe lines of the producers of oil from the wells to the lease, or settling tanks; and the lines from the lease tanks to the trunk lines as being a part of a gathering system. Also those lines running from refinery tank farms to stills, and/or loading racks or wharves, stations etc., within the refinery grounds as being a part of the refinery equipment; while those pipe lines that brought oil to the tank farms were a part of transportation equipment. The Judge, in the above case, evidently did not consider the construction by the industry, in arriving at his decision.

"Section 4 of Article 6018 reads as follows: 'Owning, operating or managing or participating in ownership, operation or management, under lease, contract of purchase, agreement to buy or sell, or other agreement or arrangement of any kind whatsoever, any pipe line or pipe lines, or part of any pipe line, for transportation from any oil field or place of production within this State to any distributing, refining or marketing center or reshipping point thereof, within this State, or crude petroleum bought of others; Also in this connection Article 7105 should be read, especially that part reading as follows:

"'Each incorporated. . . . oil pipe line company, and all common carrier pipe line companies. . . . engaged in the transportation of oil . . . in addition to the ad valorem taxes on tangible properties which are or may be imposed upon them respectively, by law, shall pay an annual tax to the State. . . on their intangible assets and property, and local taxes thereon to the counties in which its business is carried on.' The underscored words may be applied to Company E.

"It should be pointed out here that none of these companies have declared themselves to

be common carrier pipe lines, nor have they attempted to exercise the privileges under Articles 6020, 6022 or 6043. However, they do file all reports with the Comptroller of Public Accounts and with the Railroad Commission of Texas, that are required of common purchasers and transporters of crude petroleum. They are either Delaware corporations, or they are incorporated under Articles 1495, 1496, 1497 and 1503.

"Should this not be enough information necessary for you to decide these questions I shall be glad to go into more detail, personally."

You have verbally amplified the foregoing statement in connection with "Company D" by advising us that, as in the case of "Company C", part of the oil handled was either purchased from or transported for other producers in the field and was not confined to the production of said "Company D".

In answering your first question we point out that under principles hereafter discussed, we hold that Companies "C", "D" and "E", above described, are engaged, in part, in businesses of such nature as to bring each of them within the application of Article 7105, Revised Civil Statutes, providing for the assessment, for taxation, of the intangible values of each "oil pipe line company", "common carrier pipe line company" or "other individual company, corporation or association doing business of the same character in this State." However, it does not follow from this conclusion that all gross income received by each of these companies, from every source, can be properly considered by the State Tax Board in computing the intangible values of the businesses enumerated in the statute, under the established principle of "capitalization of net earnings", because such companies, particularly Companies "C" and "D", are also engaged in the producing and refining business, respectively, and such businesses are not within said Act. It is our answer to your first question that the Board may consider as gross income for these purposes, only such income as accrues, directly or indirectly, from the business of transporting crude oil for others for hire or for profit. Thus, if crude oil is transported by the companies in question for other producers, from the point of production to

refineries owned by others, or to connecting pipe line carriers, for a charge or consideration of five cents per barrel, such gross income, along with other income traceable to the business of transporting oil for hire, would be properly considered by the Board in determining intangible value under established formulas, whether such income is designated as carrying, gathering or service charge or tariff. The formal publication of a tariff, under regulations of the Railroad Commission (Article 6043, Revised Civil Statutes) is no condition prerequisite to bringing the companies here within the intendment of the Act taxing intangibles.

But if each of the described companies purchase such crude oil outright from producers and transport same through their gathering system, or pipe line system, to another refinery or to a connecting pipe line, where it is sold for a profit, then, under the case of Reagan County Purchasing Company v. State, 110 S. W. (2d) 794, the Board may consider, in assessing intangible values, only such portion of the total consideration or gross income received by such companies as represents a fair, just and reasonable charge for the carriage or transportation of such oil. The balance, if any, over and above such transportation charges, would be considered as trading profits or income from the purchase and sale of crude oil, and would not be income derived from the business of transporting oil for hire. Corporations chartered under Chapter 15, Title 32, Revised Civil Statutes, such as these are indicated to be, are authorized to pursue both businesses; i.e., transport crude oil by pipe line for hire and buy and sell crude oil.

Upon this point of excluding trading profits in assessing intangible values of such companies, the trial court, in the case of Reagan County Purchasing Company v. State, supra, found:

> "'. . . Said value was assessed and fixed by the State Tax Board by a process of "capitalizing" what it understood and believed to be the entire net revenue of the defendant for the year 1934, taking into consideration earnings of said defendant from all of its activities, that is to say, earnings from the purchase and sale of oil, as well as earnings that might be

properly attributed to the transportation of oil; the computations of said Board being based upon a gross earning of 20 cents per barrel from each and every barrel of oil bought, transported and sold by the said purchasing company during the calendar year 1934.'"

The trial judge concluded that the assessment was excessive because the State Tax Board took into consideration the profits earned by the company from the business of buying and selling oil, and undertook to determine what part of the net earnings of said Company was attributable to transportation of oil, so as to fix therefrom the total taxable value of its oilpipe line business by the approved method known as "capitalization of net income".

Upon this point the findings of the court are as follows:

"'(7) I find that only one-fourth (1/4) of the gross earnings of the defendant on oil bought, transported and sold by it during the year 1934, is properly attributable to and should be allocated to gross earnings as from pipe line transportation instead of the entire 20 cents per barrel used by the said Tax Board. While, as found above, no transportation or tariff charges are made or published by the defendant, I find as a fact that 5 cents per barrel would be and constitutes a fair and reasonable charge for the transportation of such oil if it had been transported for others for hire, and that 5 cents was the transportation rate determined and used by the defendant as the basis for computation of the Federal Excise Tax on the transportation of oil by pipe line under Federal statutes existing at the time said intangible assessment was made. On the basis of a gross earning of 5 cents per barrel for all oil transported during the year 1934, and applying thereto the formula adopted and used by the State Tax Board for determining the intangible value of the defendant for the taxable year 1935, I find that 60 per cent of the intangible value of the defendant, attributable to its pipe line system and operations

as of the year 1935, is $769,408.00. . . ."

Although, in the absence of a cross-assignment of error by the State, the Court of Civil Appeals pointed out that it was unnecessary to determine the question, nevertheless, said court refused to disturb the discretion of the trial court in reviewing and adjudging the correct assessment which should have been made by the State Tax Board in this case.

Under the same reasoning, we do not believe that the Board can properly consider, in computing intangible values of the companies involved here, the worth or value of their pipe lines in the savings effected by them (1) in transporting oil produced by them or purchased from others to the refinery owned by them, (Company D), or, (2) transporting oil produced by them to a connecting common carrier trunk line (Company C). Under the holding of Col-Tex Refining Co. v. Hart, 144 S. W. (2d) 909, such use of a pipe line to transport crude oil would be as a "private pipe line", incidental to the refining business or to the oil producing business, and the value of such pipe lines, when used in the refining or producing business, to dispense with the hiring of common carrier pipe lines, cannot be considered as income derived from the business of transporting oil for hire, within the meaning of Article 7105, Revised Civil Statutes, as interpreted by said case.

In this connection, however, we point out that the State Tax Board, in assessing these described companies for intangible values, may consider the earning capacity of the property as distinguished from the actual earnings. Under the "capitalization of net income" method of valuation, declared by the court to be particularly adaptable to pipe line companies and various other public utility companies, the earnings are merely treated as a guide to the capital value, because the tax is not levied upon the earnings as such. Therefore, in any particular case, the gross receipts to be considered for such purpose are not necessarily the actual receipts but such as would be received under a reasonably economical and prudent management; and the expenses to be deducted, in order to determine the net income, are not necessarily the expenses which were in fact incurred, but

such expenses as would be incurred under a reasonably economic and prudent management. 26 R. C. L. 367; State v. Nevada Cent. R. Co., et al, 81 Pac. 99.

By your second question you ask if there is any "yard-stick to be used in measuring or classifying a pipe line operated in connection with the refining or production of crude oil." This "yardstick" has been definitely laid down by the decision of the Court of Civil Appeals in the case of Col-Tex Refining Co. v. Bruce Hart, et al, supra, and the pertinent statutes. Article 6018, Revised Civil Statutes, after giving four broad definitions of a common carrier pipe line company, provides that "the provisions of this law shall not apply to those pipe lines which are limited in their use to the wells, stations, plants and refineries of the owner and which are not a part of the pipe line transportation system of any common carrier as above defined." In Chapter 15, Title 32, Revised Civil Statutes, governing the creation and operation of corporations for the storing, transporting, buying and selling of oil, gas, salt brine and other mineral solutions, etc., we find Article 1503, providing:

> "Nothing in this chapter shall preclude the ownership or operation by any corporation, of private pipe lines in and about its refineries, fields or stations, even though such corporations may be engaged in the producing business."

It was held in the case of Col-Tex Refining Company v. Hart, et al, supra, that a refining company, owning and using a pipe line exclusively for the purpose of transporting oil bought by the company from other producers to the refinery owned by it, was not an "incorporated oil pipe line company", a "common carrier pil pipe line company" or "doing business of the same character" within the terms of Article 7105, Revised Civil Statutes, and hence was not subject to the tax on intangibles thereby assessed. This holding was upon the theory and construction that the intangible tax statute was intended to embrace only such property or facilities as produced for the owner within and of itself, and apart from any other business of the owner, a tangible revenue

or income, and hence carrying system of pipe lines owned by refining company for use in transporting oil from production to such refinery, did not have a tangible value to which the intangible tax measure attached.

But we are not willing to extend this decision to cover and exempt persons, firms or corporations using pipe lines for the transportation of crude oil for hire, even though such pipe line system is called a gathering system and is also used in connection with the refining or producing business of such person, firm or corporation. In other words, to bring the owner, lessee or operator of such gathering or pipe line system within the principle announced by the Col-Tex case, it must be used exclusively (1) to transport oil produced by such owner or operator, and not bought of others, to a connecting common carrier pipe line for sale to it or further transporation by it, or, (2) to transport oil produced or purchased by such owner, operator, or lessee to a refinery owned and operated by the same person, firm or corporation for processing.

If, on the other hand, such pipe line or gathering system is used, in addition to the purposes set out above, (1) for the purpose of transporting, for hire, charge, tariff, or other consideration, crude oil for other producers from the place of production to a connecting pipe line for sale or further transportation, or to a refinery owned and operated by another person, firm or corporation for processing, or (2) for the purpose of transporting oil purchased by the owner, operator or lessee of such pipe line or gathering system, from others, to a connecting pipe line company for sale or further transportation, or to the refinery of another person, firm or corporation for sale, then in each of these situations, exemplified by the companies described in your letter, it is our opinion that you may lawfully assess an intangible value, for taxation purposes, by capitalizing the profit or income which accrues from such transportation, subject to the above discussed limitations.

By your third question you ask if "an intangible value, as found, attaches itself to the physical properties, or to the business of transporting oil by pipe line", pointing

out that "Company E" would have office furniture and other property used in their marketing and pipe line business but intangible value would ordinarily be apportioned to the counties through which the pipe lines were situated. Although an intangible value could not exist in any given case without the presence of tangible or physical properties used in or devoted to the business out of which the intangible value arises, including office furniture and equipment in the instant case, if necessarily incident to the proper conduct of the business of engaging in the transportation by pipe line of crude oil for hire, nevertheless, it is our opinion that such intangible value need not by the Board be apportioned and certified to the county or counties where such office furniture, and equipment or other tangible property is situated, but the practice, long followed by the Board, of apportioning such intangible values, on a mileage value, to each of the counties through which the pipe line runs, is proper, and may be continued.

In the case of Reagan County Purchasing Company v. State, 110 S. W. (2d) 1194, the court said:

> "Intangible values ordinarily result from the profit of a business as actually conducted. They inhere to it as a 'going concern,' in many cases far exceeding the tangible values to which they adhere."

Thus, although intangible value cannot exist, for purposes of taxation, without the existence of tangible or physical properties to which such intangible values adhere and out of which they grow, it is not technically accurate to say that intangible value attaches itself to such physical or tangible properties, so as to have a situs for taxation in the counties where such properties are located, because the intangible value sought to be assessed for ad valorem taxes under Article 7105, Revised Civil Statutes, is the over-all value of the business conducted as a "going concern", which business has a valuation in excess of the valuation of the physical or tangible property used in such business.

Article 7111, Revised Civil Statutes, provides that the Board "shall apportion the sum of the said total taxable values within this State to the counties in which such individual company, corporation or association does business, in proportion to the amount of business done in and the receipts derived from each such company, except, that in case of a railroad company, the apportionment to each county shall be in proportion to the line or lines of such individual, company, corporation or association therein."

Said article further provides that the Board may consider evidence upon the question of apportionment, and may certify and apportion such intangible values according to any method of calculation which it believes to be best calculated "to bring about a just, fair, equitable and lawful apportionment". Adverting to this statutory authority conferred upon the Board, the Court of Civil Appeals in the case of Texas Pipe Line Company v. Anderson, 100 S. W. (2d) 754, upheld the mileage basis of apportionment of the intangible values of a common carrier pipe line company as a method approved by the courts and calculated to reach a just and fair result.

Trusting the foregoing fully answers your inquiry, we are

Yours very truly

ATTORNEY GENERAL OF TEXAS

APPROVED APR 16, 1941

FIRST ASSISTANT
ATTORNEY GENERAL

By Pat M. Neff, Jr.
Assistant

PMN:LM

APPROVED
OPINION
COMMITTEE
BY BWB
CHAIRMAN